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C O N F I D E N T I A L SECTION 01 OF 02 BAKU 000828

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DEPARTMENT FOR EUR/SNEC AND EB/ESC
DEPT OF ENERGY FOR FE - SWIFT AND OS - WILLIAMSON

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SUBJECT: EB/CBA SPECIAL REP FRANK MERMOUD ATTENDS FORUM FOR
WESTERN ENERGY COMPANIES IN AZERBAIJAN

Classified By: Charge d, Affaires Jason P. Hyland, reasons 1.4 (b), (d)
and (e).

11. (C) SUMMARY. Representatives from McDermott Caspian Construction, ExxonMobil, ConocoPhillips, Statoil and BP participated in the Charge's Energy Forum with Frank Mermoud on May 4. Many pointed out that while they want to do further projects in Azerbaijan, working levels of the GOAJ and SOCAR seem to want to stand pat. They also noted that the Barmek experience is a vivid example of problems with the business climate. While company representatives recognize that some of this is natural, as Azerbaijan shifts from construction to operations and becomes more like other oil and gas states, they feel the decision-making structure is unclear and SOCAR's planning capacity limited. Company reps feel that while President Aliyev is enthusiastic about new gas export projects, that enthusiasm has not quite reached the bureaucracy yet, and the GOAJ has not quite understood that it can both meet domestic needs and play a significant export role. Interestingly, several representatives pointed out the paradox of how unemployment is actually rising in Azerbaijan even as the country is about to experience an influx of revenue. END SUMMARY.

MCDERMOTT

12. (C) During a May 4 energy forum with visiting EB/CBA Special Representative Frank Mermoud, the McDermott rep noted that McDermott is being forced to let many employees go as the pipeline construction projects wind down. The company is looking at a two-year lull in operations. Although the Kashagan-BTC project will require a lot of construction work, the McDermott rep noted that it will be at least a year before any contracts for that project would be put out for bid. That said, the McDermott rep stressed that his company wants to stay engaged in the Caspian. If Azerbaijan would grant a tax-free zone similar to what McDermott enjoys in the Persian Gulf and in Indonesia, the McDermott rep said that the company would happily make Azerbaijan the hub of all its operations in the region. The McDermott rep believes that the way to maximize the use of qualified workers in Azerbaijan and Kazakhstan would be for both countries to establish free-trade zones as part of a wider regional initiative in the Caspian.

However, he added, this would require a real commitment to broad, multi-sector liberalization on behalf of both governments.

STATOIL

13. (C) The Statoil representatives raised the issue of Turkish electrical-distribution company Barmek, now the subject of a very public investigation that many feel came about because of the company's connection to jailed former Economic Development Minister Farhad Aliyev. Barmek's experience "will put a chill" on all foreign investments in Azerbaijan, said the Statoil reps, especially in sectors of the economy not protected by Production Sharing Arrangements (PSAs) such as those enjoyed by Statoil and other oil and gas majors. As a result, the Statoil reps argued, "the only non-energy investor in Azerbaijan will be Russia," whose companies are concerned more with presence and control than with investment and profit.

14. (C) The Statoil reps said that their company wants to do more in Azerbaijan - to fully develop the Shah Deniz gas field, for example, and to explore further the ACG oil field. However, they sense a seeming reluctance on the part of state oil company SOCAR and the GOAJ to do more. Recent changes in Azerbaijan's energy leadership have made it difficult to create momentum, they said. Natic Aliyev has apparently been sidelined by being moved to the relatively inactive Ministry of Energy and Industry. SOCAR is still important, said the Statoil reps, but its powerful former foreign investments chief, Valekh Alasgarov, is now in parliament and current president Rovnag Abdullayev has very

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little experience in "upstream" work. The Statoil reps said that President Aliyev expressed strong interest in further projects with the Shah Deniz gas field during the visit of Statoil President and CEO Helge Lund, but that enthusiasm has not percolated through the SOCAR bureaucracy yet. The GOAJ needs to realize that it is not faced with a choice between satisfying domestic gas needs or being a major gas exporter, said the Statoil reps. Azerbaijan has enough gas to do both, they argued, but the GOAJ working level does not seem to understand that yet.

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BP
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15. (C) The BP representative made several interesting points. Rhetorically speaking, she asked, is Barmek's experience that unique? In comparison to other oil and gas countries, like Venezuela or Bolivia, Azerbaijan's investment climate is actually quite friendly, she pointed out. Azerbaijan may simply be "normalizing" and becoming more like other oil and gas states, now that the desperate years of the early 1990s are past. The BP rep pointed out that the major projects in Azerbaijan are moving out of the construction phase and into the operational phase - this means that new interest groups are emerging. Decision centers are multiplying and many decisions are no longer being made by SOCAR.

16. (C) That said, the BP rep went on to say that there are worrisome trends. Agreeing with the Statoil reps, she said that the attitude among many in Azerbaijan's energy leadership is that "the gas and oil isn't going anywhere" and can be exploited at leisure. This is the kind of attitude that leads to missed opportunities, she noted. SOCAR's capacity for strategic planning is questionable, as is its ability to market its resources, particularly gas. The intentions and behavior of the GOAJ are also critical. The BP rep noted that the GOAJ is already expressing concern about the loss of jobs mentioned by the McDermott representative. A strange picture may emerge, she noted, of

oil revenues growing while at the same time unemployment grows. A large portion of the workforce is mobile, she added, and many Azerbaijanis are leaving the country and working on new projects in Siberia or the Persian Gulf.

EXXONMOBIL AND CONOCOPHILLIPS

¶8. (C) The ExxonMobil rep and the ConocoPhillips rep commented briefly on the progress of the Azerbaijan-Kazakhstan Inter-Governmental Agreement (IGA) for cross-Caspian oil transport. Both identified the issue of the "Marine Transporter" - how it is selected, who is allowed to own the ships, et cetera - as the major issue of concern to the international investors.

¶9. (C) EB/CBA Special Representative Mermoud thanked the participants for their views and said the issue of growing unemployment is of special concern. He encouraged the companies to speak with one voice on the issue, perhaps through a joint communique. He also said it is important for the companies to consider ways that projects like Shah Deniz could be accelerated.

¶10. (U) EB/CBA Special Representative Frank Mermoud has cleared this cable.
HYLAND